

Office of Inspector General

July 15, 1999

Mr. Robert Monitello, Partner  
Ernst & Young L.L.P.  
1300 Huntington Building  
925 Euclid Avenue  
Cleveland, OH 44115-1405

Re: Final Report on Quality Control Review of Ernst & Young L.L.P. Audit of  
Ohio Aerospace Institute for Fiscal Year Ended June 30, 1998  
Assignment No. A9905000  
Report No. IG-99-033

Dear Mr. Monitello:

The subject final report is provided for your use. Please refer to the Results of Review section for the overall review results.

If you have any questions concerning the report, please contact Mr. Patrick A. Iler, Director, Audit Quality, at (216) 433-5408, or Ms. Vera Garrant, A-133 Audit Manager, at (202) 358-2596. We appreciate the courtesies extended to the audit staff. The report distribution is in Appendix D.

Sincerely,

**[Original signed by]**

Russell A. Rau  
Assistant Inspector General for Auditing

Enclosure

**IG-99-033**

# **QUALITY CONTROL REVIEW REPORT**

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**ERNST & YOUNG L.L.P. AUDIT OF  
OHIO AEROSPACE INSTITUTE FOR  
FISCAL YEAR ENDED JUNE 30, 1998**

**July 15, 1999**

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National Aeronautics and  
Space Administration

**OFFICE OF INSPECTOR GENERAL**

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## **Acronyms**

NASA	National Aeronautics and Space Administration
OAI	Ohio Aerospace Institute
OMB	Office of Management and Budget

## NASA Office of Inspector General

IG-99-033  
A9905000

July 15, 1999

### **Ernst & Young L.L.P. Audit of Ohio Aerospace Institute for Fiscal Year Ended June 30, 1998**

#### ***Introduction***

Ohio Aerospace Institute (OAI) of Cleveland, Ohio, is a not-for-profit corporation organized exclusively for charitable, educational, and scientific purposes. OAI is a consortium of nine Ohio universities, the National Aeronautics and Space Administration (NASA) John H. Glenn Research Center at Lewis Field in Cleveland, the Air Force Research Laboratory in Dayton, and private companies. The OAI mission is to be a collaborative network of universities, industry, and Government, focused on the creation, integration, application, and communication of aerospace-related knowledge and the commercialization of related technologies.

As the oversight agency for audit for OAI, NASA performed a report and quality control review of the Ernst & Young LLP audit of OAI for the fiscal year ended June 30, 1998. The audit is required by Office of Management and Budget (OMB) Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations." The office of Ernst & Young L.L.P., Cleveland, Ohio, performed the single audit for OAI. The OAI reported \$7,644,092 in total direct expenditures for NASA and \$13,609,921 in total Federal expenditures for the fiscal year ended June 30, 1998.

Appendix A provides details on the single audit requirements.

**Objectives.** The objectives of our quality control review were to determine whether the audit was conducted in accordance with applicable standards and whether the audit meets the auditing and reporting requirements of OMB Circular A-133. See Appendixes B and C for details on the objectives, scope, and methodology.

**Results of Review.** Ernst & Young L.L.P. issued its audit report on OAI on October 30, 1998. The auditors identified no findings and questioned no costs. Ernst & Young L.L.P. issued an unqualified opinion on the financial statements, Schedule of Expenditures of Federal Awards, and major program compliance. The auditors also found no instances of noncompliance in the financial statement audit that must be reported under generally accepted government auditing standards. Finally, the auditors identified no material weaknesses related to internal controls for the financial statement or major programs.

The Ernst & Young L.L.P. audit work and report meet the applicable auditing and reporting guidance and regulatory requirements contained in: (1) OMB Circular A-133 and its related Compliance Supplement, (2) generally accepted government auditing standards, and (3) generally accepted auditing standards.

## **Appendix A. Single Audit Requirements**

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The Inspector General Act of 1978, as amended (Public Law 95-452), requires an agency's Inspector General to "take appropriate steps to assure that any work performed by non-Federal auditors complies with the standards established by the Comptroller General."

The Single Audit Act of 1984 (Public Law 98-502) was intended to improve the financial management of state and local governments, while OMB Circular A-133 was intended to improve financial management for nonprofit organizations. The Act and the Circular established uniform requirements for audits of Federal financial assistance; promoted efficient and effective use of audit resources; and helped to ensure that Federal departments and agencies rely on and use the audit work to the maximum extent practicable.

The Single Audit Act Amendments of 1996 (Public Law 104-156) incorporate the previously excluded nonprofit organizations. Including the nonprofit organizations strengthens the usefulness of the audits by establishing one uniform set of auditing and reporting requirements for all Federal award recipients that are required to obtain a single audit. Major changes to the Act include: (1) increasing the audit threshold from \$25,000 to \$300,000 with respect to Federal financial assistance programs before an audit is required; (2) selecting Federal programs for audit based on a risk assessment rather than the amount of funds involved; and (3) improving the contents and timeliness of single audits.

The revised OMB Circular A-133 was issued pursuant to the Single Audit Act Amendments of 1996 on June 30, 1997. In general, the Circular requires that an auditee who expends \$300,000 or more annually in Federal awards, obtain an audit and issue a report of its Federal award expenditures in accordance with the generally accepted government auditing standards applicable to financial audits. The audit must be performed by auditors who meet the independent standards in generally accepted government auditing standards and in accordance with the auditing and reporting requirements of the Circular and its related Compliance Supplement. The audit report submission contains:

- financial statements and related opinion,
- Schedule of Expenditures of Federal Awards and related opinion,
- report on the internal controls and compliance review of the financial statements,
- report on internal controls reviewed and compliance opinion on major programs, and
- Schedule of Findings and Questioned Costs.

The auditee must also submit a Data Collection Form to the Department of Commerce Clearinghouse. The form summarizes the significant information in the audit report for dissemination to the public through the Internet. Responsible officials from the audited entity and the audit organization sign the form certifying to the information presented.

## Appendix A

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The Compliance Supplement is based on the requirements of the Single Audit Act Amendments of 1996 and the final June 30, 1997, revision of OMB Circular A-133, which provide for the issuance of a compliance supplement to assist auditors in performing the required audits. The National State Auditors Association study stated:

"The Compliance Supplement provides an invaluable tool to both Federal agencies and auditors in setting forth the important provisions of Federal assistance programs. This tool allows Federal agencies to effectively communicate items which they believe are important to the successful management of the program and legislative intent . . . ."

Compliance with the Supplement satisfies the requirements of OMB Circular A-133. The Supplement identifies Federal programs by Federal agency. It identifies existing, important, compliance requirements, which the Federal Government expects to be considered as part of an audit required by the 1996 Amendments. Without the Supplement, auditors would need to research many laws and regulations for each program under audit to determine which compliance requirements are important to the Federal Government and could have a direct and material effect on a program. The Supplement is a more efficient and cost-effective approach to performing this research. It provides a source of information for auditors to understand the Federal program's objectives, procedures, and compliance requirements relevant to the audit as well as audit objectives and suggested audit procedures for determining compliance with the requirements.

For single audits, the Supplement replaces agency audit guides and other audit requirement documents for individual Federal programs and specifically states which of the following 14 compliance requirements are applicable to a major program that may be audited:

1. Activities Allowed or Unallowed
2. Allowable Costs/Cost Principles
3. Cash Management
4. Davis-Bacon Act
5. Eligibility
6. Equipment and Real Property Management
7. Matching, Level of Effort, Earmarking
8. Period of Availability of Federal Funds
9. Procurement and Suspension and Debarment
10. Program Income
11. Real Property Acquisition/Relocation Assistance
12. Reporting
13. Subrecipient Monitoring
14. Special Tests and Provisions

The Compliance Supplement assists the auditors in determining the audit scope for the Circular's internal control requirements. For each compliance requirement, the Supplement describes the objectives of internal control and certain characteristics that when present and operating effectively, may ensure compliance with program requirements. The Supplement gives examples

## **Appendix A**

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of the common characteristics for the 5 components of internal controls (control environment, risk assessment, control activities, information and communication, and monitoring) for the 14 compliance requirements.



## **Appendix B. Objectives and Scope**

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### **Audit Report Review**

The objective of an audit report review is to determine whether the report submitted by the auditee meets the applicable reporting standards and the OMB Circular A-133 reporting requirements. As the oversight Federal audit agency for OAI, we performed a review of the OAI audit report for the fiscal year ended June 30, 1998. We reviewed the report for compliance with the requirements of the Single Audit Act, Single Audit Act Amendments of 1996, and OMB Circular A-133. We focused our review on the report's qualitative aspects of: (1) due professional care; (2) auditor's qualifications and independence; (3) financial statements, compliance, and internal control reporting; (4) Schedule of Expenditures of Federal Awards; and (5) Schedule of Findings and Questioned Costs.

### **Quality Control Review**

The objectives of a quality control review are to ensure that an audit was conducted in accordance with generally accepted government auditing standards\* and generally accepted auditing standards and whether the audit meets the auditing and reporting requirements of OMB Circular A-133. As the oversight agency for audit for OAI, we conducted a quality control review of the Ernst & Young L.L.P. audit working papers. We focused the review on the audit's qualitative aspects of:

- auditor's qualifications,
- independence,
- due professional care,
- quality control,
- planning and supervision,
- Federal receivables and payables,
- major program determination,
- internal controls and compliance testing for major programs,
- Schedule of Expenditures of Federal Awards,
- Schedule of Findings and Questioned Costs, and
- Data Collection Form.

We organized our review by the general and field work audit standards and the required elements of a single audit. We emphasized the areas of major concern to the Federal Government such as determining and auditing major program compliance and internal controls. We conducted the review June 14 through 16, 1999, at the Cleveland, Ohio, offices of Ernst & Young L.L.P. and OAI. The NASA Office of Inspector General performed a quality control review at one other Ernst & Young L.L.P. location since October 1, 1998. The affected office was notified of the findings, and no further action is necessary.

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\*These standards are broad statements of the auditors' responsibilities, promulgated by the Comptroller General of the United States.

## **Appendix B**

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### **Peer Review Report**

We reviewed the November 3, 1998, report on the most recent peer review of Ernst & Young L.L.P., performed by KPMG Peat Marwick LLP. KPMG Peat Marwick LLP determined that Ernst & Young L.L.P. met the objectives of the quality control review standards established by the American Institute of Certified Public Accountants and that Ernst & Young L.L.P. complied with the standards during the fiscal year ended June 30, 1998.

## **Appendix C. Quality Control Review Methodology**

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### **Report of Independent Auditors**

The auditors are required to determine whether the financial statements are presented fairly in all material respects in conformity with generally accepted auditing principles and are free of material misstatement. The auditors are also required to subject the Schedule of Expenditures of Federal Awards to the procedures applicable to the audit of the financial statements and to ensure that the amounts are fairly stated in relation to the basic financial statements. We reviewed the audit programs and the testing of evidence to determine whether testing was sufficient based on an assessment of control risk to warrant the conclusion reached. We also reviewed the working papers to determine whether they supported the conclusion.

### **Schedule of Expenditures of Federal Awards**

The recipient is responsible for creating the Schedule of Federal Awards. The auditors are required to audit the information in the Schedule to ensure it is fairly presented in all material respects in relation to the financial statements taken as a whole. We reviewed the audit programs for the appropriate procedures, and tracked some of the amounts to the Subsidiary Ledger and/or Trial Balance.

### **Report of Independent Auditors on Compliance and on Internal Control Over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards**

The auditors are required to determine whether the recipient has complied with laws and regulations that may have a direct and material effect in determining financial statement amounts. The auditors are also required to obtain an understanding of internal controls that is sufficient to plan the audit and to assess control risk. We reviewed the audit programs for the appropriate procedures, the working paper documentation, and the compliance and substantive testing performed.

### **Report of Independent Auditor on Compliance with Requirements Applicable to Each Major Program and Internal Control Over Compliance in Accordance with OMB Circular A-133**

The auditors are required to determine whether the recipient has complied with laws, regulations, and the provisions of contracts and grant agreements that may have a direct and material effect on each of its major Federal programs. The auditors are required to use the procedures in the OMB Circular A-133 Compliance Supplement (May 1998 edition) to determine the compliance requirements for each major program. We reviewed the audit program for the appropriate procedures and compared the audit program steps to those in the Compliance Supplement to

## Appendix C

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determine whether the applicable steps had been performed. We also reviewed the working paper documentation and its support and the compliance tests performed.

To obtain an understanding of internal controls over Federal programs that is sufficient to plan an audit to support a low-assessed level of control risk for major programs, the auditors must perform procedures. The auditors must plan and perform internal controls testing over major programs to support a low level of control risk for the assertions relevant to the compliance requirements for each major program. We reviewed the audit programs for the appropriate procedures, the working paper documentation, and the test of controls performed.

### **Schedule of Findings, and Questioned Cost**

The auditors are required to prepare a Schedule of Findings and Questioned Costs that summarizes the audit results. This schedule includes information about and related to the audit that is not required to be identified in other parts of the audit report including: (1) major programs audited; (2) details on findings and questioned costs (including reportable conditions and material weaknesses); (3) dollar threshold to identify major programs; and (4) whether the recipient is considered to be low risk. We reviewed the audit programs for the appropriate procedures and the working paper documentation supporting the information in the schedule.

## **Appendix D. Report Distribution**

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Ms. Eileen Pickett, Vice President of Operations  
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### **Federal Offices of Inspector General**

Department of Commerce  
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### **National Aeronautics and Space Administration (NASA) Officials-in-Charge**

Code B/Chief Financial Officer  
Code B/Comptroller  
Code G/General Counsel  
Code H/Associate Administrator for Procurement  
Code JM/Director, Management Assessment Division

### **NASA Field Installation**

Director, John H. Glenn Research Center at Lewis Field

## **Major Contributors to the Report**

Patrick A. Iler, Director, Audit Quality

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Nancy C. Cipolla, Report Process Manager